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No. 82-191

In the Supreme Court of the United States

OCTOBER TERM, 1982

WHITE TOOL AND MACHINE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question presented in this income tax case is whether the decision below correctly upheld the Commissioner's reallocation of income among three corporations owned and controlled by the same individuals, under Section 482 of the Internal Revenue Code (26 U.S.C.), in order to offset excessive rentals paid by petitioner to the other two corporations.[1]

The pertinent facts may be summarized as follows. Petitioner, White Tool and Machine Company, was owned and controlled by Stephen White and his sons, Gary and Roger (App. 4).[2] In 1970, Stephen, Gary and Roger White

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[1]The opinion of the court of appeals is reproduced in the petition (Pet. 7-8), and is reported at 677 F. 2d 528. The memorandum opinion of the Tax Court is reproduced in the joint appendix filed in the court of appeals and is reported at 41 T.C.M. (CCH) 116.

[2]"App." references are to the joint appendix filed in the court of appeals.

formed White & Sons Rental, Inc. (Rental) and White Charter Services, Inc. (Charter) and transferred certain assets used in petitioner's business to Rental and Charter, respectively (App. 3, 5-6). Petitioner received no consideration for the transfer of any of these assets (App. 6). During 1973 and 1974, the taxable years in issue, all of the stock of petitioner and of Rental, and 90 percent of the stock of Charter, was owned by Stephen, Gary and Roger White (App. 4-5). The remaining 10 percent of the stock of Charter was owned by Elaine White, Stephen White's wife (App. 5).

In 1973 and 1974, Charter leased two trucks, two automobiles, and an airplane with a total cost basis of $43,412.14 to petitioner for a rental of $110,000 in 1973 and $140,000 in 1974 (App. 7, 13). During the same years, Rental leased machine shop operating equipment with a cumulative cost basis of $268,129.99 to petitioner for a rental of $15,000 in 1973, and $91,000 in 1974 (App. 6-7, 13-14, 109). Pursuant to Treasury Regulations on Income Tax (1954 Code), Section 1.482-2(c) (26 C.F.R.), the Commissioner determined that the rentals paid by petitioner to Rental in 1974, and to Charter in both years did not reflect an arm's length charge for the leased property and that an allocation to petitioner of the excess rental income paid to Charter and Rental was necessary in order to prevent the evasion of taxes and to reflect clearly the income of all three corporations (App. 10-12). The Commissioner's statutory allocation increased petitioner's 1973 and 1974 income by $88,744.27 and $154,230.09, respectively (App. 11-12). Although the Commissioner made correlative adjustments to the incomes of Charter and Rental, no changes were required in their tax liability because both corporations had reported no taxes due, because of the application of net operating loss carryovers and an investment credit (App. 12, 69, 74, 77, 84, 90).

The Tax Court found that petitioner had failed to prove that the Commissioner's allocations of excess rentals as income to it were arbitrary or an abuse of discretion (App.

17). It rejected petitioner's contention that the excess rentals had not produced a distortion of income because, if the income and deductions of all three corporations had been consolidated, the consolidated tax liability would have been about the same as petitioner's reported tax liability on a separate return (App. 18-19). As the court pointed out, such calculations were wholly irrelevant because petitioner was not entitled to file a consolidated return with Charter and Rental because it was not the common parent of a consolidated group, but rather one of three brother-sister corporations controlled by Stephen, Gary and Roger White (App. 18-19). The Tax Court further rejected, as unsupported by the record, petitioner's contention that part of its payments to Charter was not a rental payment but a payment for management services provided by Stephen, Elaine, Gary and Roger White (App. 26-27). The court of appeals affirmed, concluding that the findings of fact made by the Tax Court were not clearly erroneous (Pet. 8).

1. This essentially factual case does not warrant review by this Court. Petitioner contends (Pet. 4-5) that the court of appeals erred in upholding the Commissioner's allocation under Section 482 of the Code because, in its view, there was no distortion of income arising from the rentals which it paid to Charter and Rental. But by agreeing to make these excessive rental payments, petitioner deflected income otherwise taxable to it to two commonly controlled corporations which could absorb the income through the use of loss carryovers and an investment credit.

The purpose of Section 482, as provided by Treasury Regulations on Income Tax, Section 1.482-1(b)(1), is to "place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer." Where, as here, the existence of common control is undisputed, Section 482 grants the Commissioner broad discretionary

power to make allocations such as those at issue in this case. His determination will be overturned by the courts only if the taxpayer can show that it was arbitrary and unreasonable. *Spicer Theater, Inc.* v. *Commissioner*, 346 F. 2d 704, 706 (6th Cir. 1965); *Aiken Drive-In Theatre Corp.* v. *United States*, 281 F. 2d 7, 10 (4th Cir. 1960). See *Commissioner* v. *First Security Bank of Utah*, 405 U.S. 394, 404-405 (1972). The Commissioner's use of his power of allocation to prevent petitioner from deflecting its income to two commonly controlled loss corporations was plainly a reasonable and appropriate use of that authority.[3]

2. Finally, petitioner contends (Pet. 5) that the Tax Court and the court of appeals erred in rejecting its claim that the Commissioner's allocation failed (1) to take into account the management services provided by Charter under its lease agreement with the petitioner, and (2) to take into account certain rentals which had been accrued in 1973, and paid in 1974, under its lease with Rental. The Tax Court rejected petitioner's contentions on both these points as unsupported by the record (App. 25-27). It found that petitioner failed to prove the amount, if any, of the management service provided to it by Steven, Elaine, Gary and Roger White which was attributable to its lease agreement

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[3]The court of appeals correctly rejected petitioner's renewed contention (Pet. 3-4) that it could have achieved the same tax result if its business, together with the businesses of Charter and Rental, had all been conducted by a single corporation or by an affiliated group of corporations entitled to file a consolidated return under Section 1501 of the Internal Revenue Code (26 U.S.C.). As the Tax Court pointed out (App. 18-19), petitioner, Charter, and Rental were not entitled to file a consolidated return. Accordingly, they were not entitled to disregard their separate identities and deflect income at will from one to another. See *Moline Properties* v. *Commissioner*, 319 U.S. 436, 438-440 (1943). See also *Lucas* v. *Earl*, 281 U.S. 111 (1930). Indeed, Section 482 was enacted to prevent precisely this type of tax avoidance. *Rubin* v. *Commissioner*, 429 F. 2d 650, 653 (2d Cir. 1970).

covering the use and operation of the vehicles owned by Charter (App. 26-27).[4] There is no basis for review of this factual assertion.

It is therefore respectfully requested that the petition for a writ of certiorari should be denied.

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Solicitor General

SEPTEMBER 1982

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[4]The parties stipulated that petitioner had not accrued any unpaid rentals in 1973 on the machine shop equipment leased to it by Rental, but had deducted the entire $91,000 non-arm's length rental, against which the Commissioner had made his allocation, in 1974 (App. 25).